

# California State Auditor

B U R E A U O F S T A T E A U D I T S

## Department of Health Services:

*Safe Drinking Water State Revolving  
Fund Financial and Federal Compliance  
Audit Report for the Fiscal Year Ended  
June 30, 2000*



December 2000  
2000-002.1

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# CALIFORNIA STATE AUDITOR

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ELAINE M. HOWLE  
STATE AUDITOR

STEVEN M. HENDRICKSON  
CHIEF DEPUTY STATE AUDITOR

December 4, 2000

2000-002.1

The Governor of California  
President pro Tempore of the Senate  
Speaker of the Assembly  
State Capitol  
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by California Government Code, Section 8542, et. seq., the Bureau of State Audits (bureau) presents its audit report concerning our review of the Department of Health Services' (department) financial statements for the Safe Drinking Water State Revolving Fund and its compliance with federal laws and regulations applicable to the Capitalization Grants for Drinking Water State Revolving Fund program (program) for the year ended June 30, 2000. The department contracted with the bureau to perform this audit to satisfy a federal audit requirement.

This report concludes that the department's Safe Drinking Water State Revolving Fund financial statements are fairly presented. However, the department did not always comply with federal laws and regulations governing allowable costs and cost principles applicable to the program. Although none of the problems we identified are significant to the program, when the department does not comply with the requirements, it risks incurring costs that the federal government may later disallow.

Respectfully submitted,

*Elaine M. Howle*

ELAINE M. HOWLE  
State Auditor

# **Department of Health Services:**

*Safe Drinking Water State Revolving Fund  
Financial and Federal Compliance Audit Report  
for the Fiscal Year Ended June 30, 2000*

December 2000  
2000-002.1

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# ***FINANCIAL SECTION***

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# CALIFORNIA STATE AUDITOR

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ELAINE M. HOWLE  
STATE AUDITOR

STEVEN M. HENDRICKSON  
CHIEF DEPUTY STATE AUDITOR

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## ***Independent Auditor's Report***

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Department of Health Services  
State of California

We have audited the accompanying financial statements of the Safe Drinking Water State Revolving Fund of the Department of Health Services, as of and for the year ended June 30, 2000. These financial statements are the responsibility of the Department of Health Services' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Safe Drinking Water State Revolving Fund and are not intended to present fairly the financial position of the Department of Health Services and the results of its operations and the cash flows of its proprietary fund types and nonexpendable trust funds in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Safe Drinking Water State Revolving Fund of the Department of Health Services, as of June 30, 2000, and the results of its operations and the cash flows for the year then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 27, 2000, on our consideration of the Department of Health Services' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

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BUREAU OF STATE AUDITS

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The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

BUREAU OF STATE AUDITS

A handwritten signature in black ink that reads "Philip Jelicich". The signature is written in a cursive, flowing style.

PHILIP J. JELICICH, CPA  
Deputy State Auditor

October 27, 2000

**DEPARTMENT OF HEALTH SERVICES  
SAFE DRINKING WATER STATE REVOLVING FUND  
BALANCE SHEET  
June 30, 2000**

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<b>Assets</b>	
Current Assets	
Cash and pooled investments	\$30,487,200
Interest receivable	1,200
<hr/>	
Total Current Assets	30,488,400
<hr/>	
Loans receivable	371,200
<hr/>	
<b>Total Assets</b>	<b>\$30,859,600</b>
<hr/>	
<b>Equity</b>	
Retained earnings	\$30,859,600
<hr/>	
Total Equity	30,859,600
<hr/>	
<b>Total Liabilities and Equity</b>	<b>\$30,859,600</b>

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The accompanying notes are an integral part of the financial statements.

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**DEPARTMENT OF HEALTH SERVICES  
SAFE DRINKING WATER STATE REVOLVING FUND  
STATEMENT OF REVENUES, EXPENSES, AND  
CHANGES IN RETAINED EARNINGS  
Year Ended June 30, 2000**

<b>Operating Revenues</b>	
Interest on loans	\$ 1,200
<b>Total Operating Revenues</b>	<b>1,200</b>
<b>Operating Revenues</b>	<b>1,200</b>
<b>Nonoperating Revenues</b>	
Federal grants	304,400
State match	15,417,000
<b>Total Nonoperating Revenues</b>	<b>15,721,400</b>
<b>Net Income</b>	<b>15,722,600</b>
<b>Retained Earnings, July 1, 1999</b>	<b>15,137,000</b>
<b>Retained Earnings, June 30, 2000</b>	<b>\$30,859,600</b>

The accompanying notes are an integral part of the financial statements.

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**DEPARTMENT OF HEALTH SERVICES  
SAFE DRINKING WATER STATE REVOLVING FUND  
STATEMENT OF CASH FLOWS  
Year Ended June 30, 2000  
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS**

Cash flows from noncapital financing activities:	
Federal grants received	\$ 304,400
State match received	15,417,000
<hr/>	
Net cash received (used) from noncapital financing activities	15,721,400
<hr/>	
Cash flows from investing activities:	
Loans disbursed	(371,200)
<hr/>	
Net cash used for investing activities	(371,200)
<hr/>	
Net increase in cash and cash equivalents	15,350,200
Cash and cash equivalents at beginning of year	15,137,000
<hr/>	
<b>Cash and cash equivalents at end of year</b>	<b>\$30,487,200</b>

<b><i>Reconciliation of operating income to net cash received (used) for operating activities:</i></b>	
<hr/>	
Operating Income	\$1,200
Adjustments to reconcile operating income to net cash received (used) for operating activities:	
Change in assets and liabilities:	
Increase in interest receivable	(1,200)
<hr/>	
Total reconciling adjustments	(1,200)
<hr/>	
<b>Net cash received (used) for operating activities</b>	<b>\$ 0</b>

The accompanying notes are an integral part of the financial statements.

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## ***Notes to the Financial Statements***

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### ***Note 1. Summary of Significant Accounting Policies***

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The accompanying financial statements present the financial position and the results of operations of the Safe Drinking Water State Revolving Fund for the year ended June 30, 2000. The financial statements have been prepared in conformity with generally accepted accounting principles applicable to government entities. The provisions of Governmental Accounting Standards Board Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions, have been implemented in this report. The following is a summary of significant accounting policies that pertain to these financial statements.

#### ***Reporting Entity***

The Department of Health Services (department) administers the Safe Drinking Water State Revolving Fund (revolving fund). Created pursuant to the Health and Safety Code, Section 116760.30, the revolving fund is continuously appropriated without regard to fiscal year and is financed by federal capitalization grants and state matching amounts. The department uses the revolving fund to make loans to public water systems to finance the cost of infrastructure needed to achieve or to maintain compliance with the Safe Drinking Water Act requirements and to protect public health.

The revolving fund does not include administrative costs. These costs are recorded in another fund. The establishment of a separate fund to account for the costs related to the administration of the revolving fund is consistent with federal guidelines.

#### ***Fund Accounting***

The revolving fund is classified as an enterprise fund. Enterprise funds account for goods or services provided to the general public on a continuing basis when (1) the department intends that all or most of the cost involved is to be financed by user charges or (2) periodic measurement of the results of operations is appropriate for management control, accountability, capital maintenance, public policy, or other purposes. For purposes of the Statement of Cash Flows, all cash and pooled investments, as discussed in Note 2, are considered to be cash equivalents.

#### ***Measurement Focus and Basis of Accounting***

The revolving fund is accounted for on the flow of economic resources measurement focus. This measurement focus emphasizes the determination of net income. Additionally, it is reported using the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned and become measurable, and expenses are recognized when incurred.



**Note 2. Cash and Pooled Investments**

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All monies of the revolving fund are deposited with the State Treasurer's Office. The State Treasurer's Office administers a pooled investment program for the State. This program enables the State Treasurer's Office to combine available cash from all funds and to invest cash that exceeds current needs. The necessary disclosures for the State's pooled investment program are included in the general purpose financial statements of the State of California.

**Note 3. Loans Receivable**

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The revolving fund makes loans to qualified local entities at interest rates ranging between 0 percent and 50 percent of the average rate paid by the State on general obligation bonds. Loans must be repaid within 20 years of completion of the project (30 years for financially disadvantaged communities). All repayments, including interest and principal, must be deposited in the revolving fund.

The department disburses the loan proceeds on a reimbursement basis. As entities spend money on projects financed by the revolving fund and request reimbursement, the department releases their loan proceeds. Interest accrues on all loan disbursements as of the date each disbursement is made. There is no provision for uncollectible accounts because this is the first year the department has issued loans. Only one loan receivable totaling \$371,200 was outstanding as of June 30, 2000.

**Major Loan Commitments to Entities**

As of June 30, 2000, the revolving fund had made loan commitments to two entities that, in the aggregate, totaled \$7 million. The remaining loan commitment balances of these loans are as follows:

<b>Entity</b>	<b>Authorized Loan Amount</b>	<b>Outstanding Balance</b>	<b>Remaining Loan Balance</b>
Solano Irrigation District	\$2,127,300	\$371,200	\$1,756,100
El Dorado Irrigation District	4,843,500	0	4,843,500
<b>Totals</b>	<b>\$6,970,800</b>	<b>\$371,200</b>	<b>\$6,599,600</b>

The authorized loan amounts are for projects in progress. As of June 30, 2000, there were no principal repayments from the above entities and the remaining amount to be disbursed on projects in progress was \$6.6 million.

**Note 4. Fund Financing**

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The revolving fund is financed by annual grants from the U.S. Environmental Protection Agency (EPA) and a State match equal to 20 percent of the federal award.

Of the amount awarded by EPA, the department has designated \$17.3 million for set-asides, which are accounted for in other funds, and used \$304,400 for loans. The grants awarded, amounts drawn on each grant, and the balances available for future loans as of June 30, 2000, are presented below:

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<b>Year</b>	<b>Grant Award</b>	<b>Less Set-Asides</b>	<b>Award Available to Revolving Fund</b>	<b>Amount Drawn for Loans</b>	<b>Available for Loans as of June 30, 2000</b>
1997	\$75,682,600	\$12,411,900	\$63,270,700	\$304,400	\$62,966,300
1998	77,108,200	4,934,900	72,173,300	0	72,173,300

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The State's matching contributions have been provided through appropriations from the General Fund. Since the revolving fund's inception, the State has contributed \$30.6 million. The State's contributions for fiscal years 1998-99 and 1999-00 are presented below:

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<b><i>Fiscal Year 1998-99</i></b>	\$15,137,000
<b><i>Fiscal Year 1999-00</i></b>	15,417,000
<b><i>Total</i></b>	<b>\$30,554,000</b>

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**Note 5. Subsequent Events**

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There were no events following the fiscal year-end requiring disclosure in these financial statements.

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# ***AUDITOR'S SECTION***

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# CALIFORNIA STATE AUDITOR

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ELAINE M. HOWLE  
STATE AUDITOR

STEVEN M. HENDRICKSON  
CHIEF DEPUTY STATE AUDITOR

## **Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards**

Department of Health Services  
State of California

We have audited the financial statements of the Department of Health Services' Safe Drinking Water State Revolving Fund as of and for the year ended June 30, 2000, and have issued our report thereon dated October 27, 2000. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### **COMPLIANCE**

As part of obtaining reasonable assurance about whether the Department of Health Services' Safe Drinking Water State Revolving Fund financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

### **INTERNAL CONTROL OVER FINANCIAL REPORTING**

In planning and performing our audit, we considered the Department of Health Services' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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This report is intended solely for the information and use of management, the State Legislature, and the federal awarding agency and is not intended to be and should not be used by anyone other than these specified parties.

BUREAU OF STATE AUDITS

A handwritten signature in black ink that reads "Philip Jelicich". The signature is written in a cursive style with a large, prominent initial "P".

PHILIP J. JELICICH  
Deputy State Auditor

October 27, 2000



# CALIFORNIA STATE AUDITOR

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ELAINE M. HOWLE  
STATE AUDITOR

STEVEN M. HENDRICKSON  
CHIEF DEPUTY STATE AUDITOR

## **Independent Auditor's Report on Compliance With Requirements Applicable to the Federal Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133**

Department of Health Services  
State of California

### **COMPLIANCE**

We have audited the compliance of the Department of Health Services with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to the Capitalization Grants for Drinking Water State Revolving Fund program for the year ended June 30, 2000. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Department of Health Services' management. Our responsibility is to express an opinion on the Department of Health Services' compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on the Capitalization Grants for Drinking Water State Revolving Fund program occurred. An audit includes examining, on a test basis, evidence about the Department of Health Services' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department of Health Services' compliance with those requirements.

In our opinion, the Department of Health Services complied, in all material respects, with the requirements referred to above that are applicable to its Capitalization Grants for Drinking Water State Revolving Fund program for the year ended June 30, 2000. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item number 00-B-1.

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## INTERNAL CONTROL OVER COMPLIANCE

The management of the Department of Health Services is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department of Health Services' internal control over compliance with requirements that could have a direct and material effect on its Capitalization Grants for Drinking Water State Revolving Fund program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of management, the State Legislature, and the federal awarding agency and is not intended to be and should not be used by anyone other than these specified parties.

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PHILIP J. JELICICH, CPA  
Deputy State Auditor

October 27, 2000

**DEPARTMENT OF HEALTH SERVICES  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Year Ended June 30, 2000**

***Summary of Auditor's Results***

**Financial Statements**

Type of report the auditor issued?	Unqualified
Internal control over financial reporting:	
Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	None reported
Noncompliance material to the financial statements noted?	No

**Federal Award**

Internal control over the program:	
Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	None reported
Type of report the auditor issued on compliance for the program?	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of OMB Circular A-133?	Yes
Auditee qualified as low-risk auditee?	No

*Identification of the program:*

<b><u>CFDA Number</u></b>	<b><u>Name of Federal Program</u></b>
66.468	Capitalization Grants for Drinking Water State Revolving Fund

***Financial Statement Findings***

No findings were reported.

## **Federal Award Findings and Questioned Costs**

### **U.S. ENVIRONMENTAL PROTECTION AGENCY**

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Reference Number:	00-B-1
Federal Catalog Number:	66.468
Federal Program Title:	Capitalization Grants for Drinking Water State Revolving Fund
Federal Award Number and Calendar Year Awarded:	FS989349-99-0; 1999
Category of Finding:	Allowable Costs and Cost Principles
State Administering Department:	Department of Health Services

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#### **CRITERIA**

Our review of the Capitalization Grants for Drinking Water State Revolving Fund program (program), identifies the following requirements related to allowable costs and costs principles:

The U.S. Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments* (OMB Circular A-87), establishes the principles and standards for determining allowable costs for federal awards. OMB Circular A-87, Attachment A, Section C.3, states that costs can be allocated to a particular federal award if the goods or services involved are chargeable to such award in accordance with the relative benefits received.

OMB Circular A-87, Attachment B, Section 11.h, additionally establishes the standards for time distributions that support salaries and wages. This section requires that, when employees work on multiple cost objectives or programs, agencies support with personnel activity reports any salaries and wages charged to a federal award. Among other requirements, these activity reports must reflect an after-the-fact distribution of each employee's actual activity, must be prepared at least monthly, and must be signed by the employee.

#### **CONDITION**

The Department of Health Services (department) did not always accurately allocate personnel costs to the program and did not require all program employees to complete and sign activity reports. We reviewed the department's allocation of personnel costs to the program for 24 employees, each for a month, and found that it overcharged the program at least \$44,612. Specifically, for the period July through December 1999, the department overcharged the program at least \$30,394 for the 12 employees we reviewed during this six-month period because it did not have a system to allocate personnel costs to the program using the employee-activity reports. For all 12, the department allocated 100 percent of these employees' costs

to the program even though the activity reports for 7 of these employees indicate they did not work on the program for the months we reviewed. The remaining 5 had no activity reports although 4 of them said they worked 100 percent on the program and one said he worked 50 percent on the program. Beginning January 2000, the department established a system to allocate personnel costs to the program using employee-activity reports. However, because it did not have a process to monitor and correct inaccurate allocations, the department overcharged at least another \$14,218 to the program for 3 of the 12 employees we reviewed during the January through June 2000 period.

Finally, 10 of the 19 employees who completed activity reports did not sign them. These errors occurred because the department did not provide specific instructions for signing and dating the reports. When the department does not require employees to complete and sign activity reports, it risks having the federal agency disallow the related costs because of inadequate documentation. In August 2000, the department took action to correct this deficiency by requiring program employees and supervisors to sign, date, and retain copies of the activity reports.

### **RECOMMENDATION**

The department should monitor its monthly allocation of personnel costs to the program and ensure it accurately allocates these costs based on information from the employee-activity reports. The department should also review the January through June 2000 personnel cost allocations and make the adjustments necessary to ensure the accounting records reflect the related costs from the program activity reported on the employee activity reports.

To ensure that the activity reports are completed, signed, and retained as required, the department should monitor the implementation of its recent procedures requiring employees and supervisors to sign and retain the activity reports.

### **DEPARTMENT'S VIEW AND CORRECTIVE ACTION**

The department agrees with our finding and plans to take corrective action. The department states that, since January 2000, program employees have been completing the required activity reports and it is using these reports to allocate personnel costs to the program. Although the process to allocate these costs to the program went as planned, unforeseen circumstances outside of its control, however, caused the exceptions that occurred after January 2000. The department acknowledges that it will need to monitor the process more closely to identify and adjust inaccurate allocations. The department additionally states that it is in the process of correcting the program overcharges in the accounting records. Finally, the department has clarified to its program employees that they must sign activity reports.

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## ***AUDITEE'S SECTION***

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**DEPARTMENT OF HEALTH SERVICES  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
Year Ended June 30, 2000**

<b>Federal Agency/Program Title</b>	<b>Federal Catalog Number</b>	<b>Federal Expenditures</b>
<b>U.S. Environmental Protection Agency:</b> Capitalization Grants for Drinking Water State Revolving Fund	66.468	\$4,110,000

The accompanying notes are an integral part of this schedule.



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**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**Year Ended June 30, 2000**

**1. *Basis of Presentation***

The accompanying schedule of federal expenditures of federal awards (schedule) includes the federal Capitalization Grants for Drinking Water State Revolving Fund grant activity of the Department of Health Services. The schedule is presented on the modified accrual basis of accounting. The information presented in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements.

**2. *Loans to Subrecipients***

Of the federal expenditures presented in the schedule, the Department of Health Services disbursed \$304,400 in loan proceeds to one subrecipient, the Solano Irrigation District.

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## Summary Schedule of Prior Audit Findings

Reference Number:	<b>99-B-1</b>
Federal Catalog Number:	66.468
State Administering Department:	Department of Health Services
Fiscal Year Finding Initially Reported:	1998-99
Audit Finding:	<b>Allowable Costs and Cost Principles.</b> The Department of Health Services (department) did not always obtain required federal agency approval before purchasing equipment. Additionally, it did not always receive time reports from employees and, in cases when it did, it did not always distribute the related personnel costs properly to the program.
Status of Corrective Action:	The department received from the federal agency clarification that approvals are only required when equipment purchases are \$5,000 or more per unit of equipment. Additionally, beginning with the January 2000 pay period, the department requires each program employee to prepare activity reports, and it established a system to distribute the personnel costs using these activity reports. <sup>1</sup>

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<sup>1</sup> Although the department established a system to distribute personnel costs using the employee activity reports, we reported a similar weakness during our audit of fiscal year 1999-2000. Please refer to reference number 00-B-1 for additional information.

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Audit Staff: Sylvia L. Hensley, CPA, Deputy State Auditor  
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